Audit & Governance Committee
22 November 2023

Treasury Management Mid Year Report 2023/24

Purpose of the report:

This report summarises the Council's treasury management activity during the first half of 2023/24, as required to ensure compliance with CIPFA's Code of Practice for Treasury Management.

Recommendations:

The Audit & Governance Committee is asked to note the content of the Treasury Management Mid-Year Report for 2023/24.

Introduction:

1. The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice (the CIPFA Code) which requires the Council to produce treasury management mid-year and annual reports.

2. The Council's Treasury Management Strategy Statement for 2023/24 was approved at the Audit and Governance Committee meeting on 18 January 2023. The investing and borrowing of cash potentially expose the Council to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

3. This report includes the requirement in the 2021 Code, mandatory from 1st April 2023, of quarterly reporting of the treasury management prudential indicators, which are also included in quarterly budget monitoring reports to Cabinet.

External Context

4. Annex 1 contains commentary from Arlingclose, our Treasury Management advisors, on the external context for Treasury Management activity and Annex 2 provides interest rate market projections.

5. The Bank of England's Monetary Policy Committee has continued tightening monetary policy over most of the period, taking Bank Rate to 5.25% in August. Against expectations of a further hike in September, the Committee voted 5-4 to maintain Bank Rate at 5.25%. Each of the four dissenters were in favour of another 0.25% increase.

6. Following the September MPC meeting, Arlingclose modestly revised its interest forecast to reflect the central view that 5.25% will now be the peak in Bank Rate. In the short term the risks are to the upside if inflation increases again, but over the remaining part of the time horizon the risks are to the downside from economic activity weakening more than expected.

7. UK inflation remained high over much of the period, compared to the US and euro zone, keeping expectations elevated of how much further the Bank of England (BoE) would increase rates compared to others. However, inflation data published in the latter part of the period undershot expectations, causing financial markets to reassess the peak in BoE Bank Rate. This was followed very soon after by the BoE deciding to keep Bank Rate on hold at 5.25% in September, against expectations of another 0.25% rise.

8. Economic growth in the UK remained relatively weak over the period. In calendar Q2 2023, the economy expanded by 0.2%. However, monthly GDP data showed a 0.5% contraction in July, the largest fall to date in 2023 and worse than the 0.2% decline predicted, which could be an indication the monetary tightening cycle is starting to cause recessionary, or at the very least stagnating, economic conditions.

Mid-Year Treasury Management Report 2023/24

Overview

9. Table 1 shows that the Council held a net borrowing position of £536m on 31 March 2023 arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Useable reserves and working capital are the underlying resources available for use in the short term to reduce the gross borrowing requirement.

10. The Treasury Management Strategy for 2023/24, approved by Audit and Governance Committee in January 2023, continued the policy of internal borrowing. This maintains borrowing below its underlying level by utilising available cash balances on a temporary basis (i.e. working capital and useable reserves) which are not required in the short to medium term. This approach reduces market and credit risk for the

investment portfolio and reduces borrowing costs. The Balance sheet position at 31 March 2023 is summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31/03/23 Actual £m
General fund CFR	1,389
Less: Other long-term liabilities	(81)
Borrowing CFR	**1,308**
Less: Balance sheet resources	(772)
Net Borrowing	**536**

11. The Council also manages cash on behalf of Surrey Police and Crime Commissioner, the balance of which was £43m as at 30 September 2023. The Council accounts for this as short-term borrowing. The treasury management position as at 30 September 2023 and the change over the six months is summarised in Table 2.

Table 2: Treasury Management Summary

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	31/03/23 Balance £m	**Movement £m**	**30/09/23 Balance £m**
Long-term borrowing*	466	(2)	464
Short-term borrowing	134	(24)	110
Surrey Police	33	10	43
Total Borrowing	**633**	**(16)**	**617**
Money Market Funds	(97)	71	(26)
Net Borrowing	**536**	**55**	**591**

*Total Long-Term Borrowing is £476m, which includes £2.1m of Local Enterprise Partnership (LEP) loans and £10m of Salix which are managed outside of the Treasury Management Strategy.

Borrowing Strategy

12. At 30 September 2023 the Council held £617m of loans (a decrease of £16m since 31 March 2023).

13. The reduction in short-term borrowing of £24m is as a result of minimising borrowing balances to minimise costs. Short term balances are expected to increase again in the second half of the year to support expected cash outflows.

14. Outstanding loans on 30 September 2023 are summarised in Table 3 below.

Table 3: Borrowing position

	31/03/23 Balance £m	Net change £m	30/09/23 Balance £m	30/09/23 Weighted average rate %	30/09/23 Weighted average maturity (years)
Public Works Loan Board	456	(2)	454	3.63	28 years
Banks (fixed-term)	10	-	10	5.00	30 years
Local Authorities (short-term)	134	(24)	110	5.17	< 1 year
Surrey Police & Crime Commissioner	33	10	43	4.44	0 days
Total Borrowing	**633**	**(16)**	**617**		

15. The Council's main objective when borrowing has been to strike a balance between securing low interest rates and achieving cost certainty over a period for which funds are required. This position provides short term savings with the flexibility to secure longer dated loans as and when the level of funds available for internal borrowing reduces, or financial forecasts indicate that external borrowing rates may increase.

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16. The Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council actively manages the borrowing position, especially in time of interest rate fluctuations, to ensure we are managing risks.

17. There was a substantial rise in the cost of both short- and long-term borrowing over the last 18 months. Bank Rate rose by 1% from 4.25% at the beginning of April to 5.25% at the end of September. Bank Rate was 2% higher than at the end of September 2022.

18. UK gilt yields were volatile, mainly facing upward pressure since early April following signs that UK growth had been more resilient, inflation stickier than expected, and that the Bank of England saw persistently higher rates through 2023/24 as key to dampening domestic demand. Gilt yields, and consequently PWLB borrowing rates, rose and broadly remained at elevated levels. On 30th September, the PWLB certainty rates for maturity loans were 5.26% for 10 year loans, 5.64% for 20-year loans and 5.43% for 50-year loans. Their equivalents on 31st March 2023 were 4.33%, 4.70% and 4.41% respectively.

19. No new long-term borrowing was undertaken in the first half of 2023/24; internal borrowing was maximised, and short-term borrowing was utilised to manage cash flow. Monthly discussions are undertaken with Arlingclose, immediately after the Bank of England's Monetary Policy Committee meetings, to review interest rate forecasts, assess the cost of carry and review the need to undertake further borrowing in advance for future years' planned expenditure.

20. CIPFA’s 2021 Prudential Code is clear that local authorities must not borrow to invest primarily for financial return and that it is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the Council.

Treasury Investment Activity

21. The CIPFA Treasury Management Code now defines treasury management investments as those investments which arise from the Council’s cash flows or treasury risk management activity that ultimately represents balances that need to be invested until the cash is required for use in the course of business.

22. The Council holds invested funds, representing income received in advance for expenditure plus balances and reserves held. During the first half of 2023/24 the Council’s average daily level of investments was £98m compared to £138m for the first 6 months of 2022/23.

23. The Council can place cash on deposit on the money market through brokers, directly with counterparties, through the use of call accounts, money market funds or direct deal facilities, or with the Debt Management Office (DMO). No new fixed term deposits have been agreed during the first half of 2023/24. All investments have been made through overnight money market funds. 11

24. The weighted average return on all investments the council received in the quarter to 30 September 2023 is 5.02%. This compares to the average Bank of England (BoE) base rate of 5.16% for the same period.

Table 4: Investment Benchmarking

	BoE base rate (average)	Weighted return on Investments
2023/24 Quarter 2	5.16%	5.02%
2023/24 Quarter 1	4.44%	4.33%
2022/23 Total	2.24%	1.83%
2021/22 Total	0.19%	0.10%

25. The progression of risk and return metrics are shown in the extracts from Arlingclose’s quarterly investment benchmarking in table 5 below.

Table 5: Investment Benchmarking – Security

	Average Credit Score	Average Credit Rating	Bail-in Exposure
2023/24 Quarter 2	4.25	AA-	100%

26. Both the CIPFA Code and the government's Investment Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money, in line with these codes of practice, is to strike and appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. In furtherance of these objectives, the Council's strategy of maximising internal borrowing has reduced the cash available for investment and reduced the scope of creating longer-term investment deposits.

Non-Treasury Investments

27. The definition of investments in the Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. Investments that do not meet the definition of treasury management investments (i.e. management of surplus cash) are categorised as either for service purposes (made explicitly to further service objectives) or for commercial purposes (made primarily for financial return).

The Council holds the following non-treasury investments:

- £98m of directly owned investment property
- £234m of loans to Halsey Garton Property Ltd
- £7m of loans to Halsey Garton Residential Ltd
- £93m of equity investments in Halsey Garton Property Ltd
- £4m of equity investments in Halsey Garton Residential Ltd
- £2m of loans to other subsidiaries

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28. It is projected that these non-treasury investments will generate £4.2m net investment income for the Council in 2023/24 after taking account direct costs, notional interest and Minimum Revenue Provision (MRP).

Treasury Performance

29. The Council measures the financial performance of its treasury management activities in terms of its impact on the revenue budget. Table 6 outlines the forecast for the interest payable and interest receivable budget for the full year of 2023/24.

Table 6: Revenue implications of treasury management activity

	Budget £m	Full Year Forecast £m	Variance £m
Interest Payable	24.5	26.4	1.9
Interest Receivable	(1.9)	(4.3)	(2.3)

30. Due to higher interest rates than forecast in budget planning, interest payable is currently forecasting an overspend. This is more than offset by increased income received on the short term cash balances held.

Treasury Advisors

31. The Council's current contract for treasury advisory services is with Arlingclose and runs for a four-year period which commenced on 1st January 2022. Arlingclose provide the Council with specific advice on investments, debt and capital finance matters.

Compliance Report

32. All treasury management activities undertaken during the first half of 2023/24 comply fully with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. Compliance with specific investment limits, the authorised borrowing limit and operational boundary for external debt, is demonstrated in tables 7 and 8 below. 11

Table 7: Debt Limits

	01/04/23 to 30/09/23 Maximum £m	30/09/23 Actual £m	2023/24 Operational Boundary £m	2023/24 Authorised Limit £m	Complied?
Total debt			1,232	1,402	
Less: Other long-term liabilities			(82)	(82)	
Underlying Borrowing	**712**	**617**	**1,150**	**1,320**	✓

33. Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not considered a compliance failure. Total debt did not exceed the operational boundary in any period during the first half of 2023/24.

Table 8: Investment Limits

	01/04/23 – 30/09/23 Maximum £m	30/09/23 Actual £m	2023/24 Limit £m	Complied?
UK Central Government	0	0	Unlimited	✓
Money Market Funds	182	26	Unlimited	✓
Any group of pooled funds under the same management	0	0	25	✓
Any group of organisations under the same ownership	0	0	20	✓
Any single organisation, except the UK Central Government	0	0	20	✓
Unsecured Investments with Building Societies	0	0	10	✓

Treasury management Indicators

34. The Council measures and manages its exposures to treasury management risks using the following indicators:

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35. **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

Table 9: Maturity Structure of Borrowing

	30/09/23 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	25%	60%	0%	✓
12 months and within 24 months	0%	50%	0%	✓
24 months and within 5 years	0%	50%	0%	✓
5 years and within 10 years	1%	75%	0%	✓
10 years and above	74%	100%	25%	✓

36. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

37. **Long-term Treasury Management Investments:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The prudential limits on the long-term treasury management investments are:

Table 10: Long-term Treasury Management Investments

	2023/24 £m	2024/25 £m	2025/26 £m	No fixed date £m
Limit on principal invested beyond year end	40	20	10	40
Actual principal invested beyond year end	0	0	0	0
Complied?	✓	✓	✓	✓

38. Long-term investments with no fixed maturity date include strategic pooled funds, real estate investment trusts and directly held equity, but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

Other Implications

Financial and value for money implications

39. The direct financial implications of this report are highlighted in table 6 and form part of the monthly budget monitoring report to Cabinet. 11

Equalities and Diversity Implications

40. There are no direct implications of this report.

Risk Management Implications

41. The noteworthy risks posed by Treasury management are outlined in the body of the report and are monitored through the Council's compliance with the approved Prudential and Treasury Management Indicators.

42. The Council engages regularly with its treasury advisors to assess the risk environment and actively manage our portfolio of borrowing, including the balance of short and long term debt. In addition, the Council holds an interest rate risk reserve to protect again unanticipated fluctuations in interest rates.

Next steps:

a. The Treasury Team will continue to monitor the UK and overseas economy and banking sector and will continue to update this Committee as appropriate.

b. In line with the requirements of CIPFA's Code of Practice for Treasury Management, a full-year report for 2023/24 will be bought to the Committee after financial year end.

c. Corporate Finance will prepare the annual Treasury Management Strategy for 2024/25, which will be presented to this Committee in January 2024 for approval.

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Sources/background papers:

- Capital, Investment and Treasury Management Strategy 2023/24
- CIPFA Code of Practice for Treasury Management (2021 Edition)
- CIPFA Prudential Code for Capital Finance in Local Authorities (2021 Edition)

Annexes:

Annex 1 - Arlingclose commentary on the External Context for Treasury Management activity
Annex 2 - Arlingclose and Market Projections

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